IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL NO.78 OF 1999

The General Insurance Corporation
of India .. Appellant
V/s
The Deputy Commissioner of Income Tax .. Respondent

Mr.F.V.Irani, Sr.Counsel with Mr.Atul Jasani for the Appellant.

Dr.P.Daniel, Sr.Counsel with Mr.A.S.Rao for the Respondent.

CORAM: DR.S.RADHAKRISHNAN &
J.H.BHATIA, JJ.

DATE : 26/07/2005.

JUDGMENT: (Per Dr.S.Radhakrishnan, J.)

1. Heard the learned Counsel for the parties. In this Appeal, the following substantial question of law has been sought to be raised:-

"Whether the ITAT erred in law in holding that "Reserve for Bad and Doubtful Debts" fell within the permissible adjustments prescribed by Rule 5(a) of the First Schedule to the Act?"

2. The Appellant had filed a Return of Income for the year ended 31.3.1991 relevant to the Assessment Year 1991-1992 declaring the income of Rs.58,52,80,850/- alongwith the audited report in Form 3CD and final accounts prepared in the manner prescribed under the Insurance Act, 1938 wherein a provision under the head **"Reserve for Bad and Doubtful Debts"** as per the regular and consistent practice, Rs.1,01,00,000/- was debited to Profit and Loss Account. On 30th August, 1993 an Assessment order was passed under Section 143(3) of the

Income Tax Act, 1961 whereby the claim of **"Reserve for Bad and Doubtful Debts"** in the sum of Rs.1,01,00,000/- was disallowed on the ground that such a disallowance was not prohibited by rule 5 of the First Schedule of the Act, and credit of the amount of the debts to the **"Reserve for Doubtful Debts"** did not constitute a write off of the debts for the purposes of Section 36 of the Act.

3. Aggrieved thereby, the Appellant had preferred an Appeal before the Commissioner of Income Tax (Appeals). The Commissioner of Income Tax (Appeals) by his order dated 18th March, 1994 allowed the Appeal holding thereby that the deduction of Rs.1,01,00,000/- in respect of **"Reserve for Bad and Doubtful Debts"** was valid. Aggrieved thereby, the Department had approached the Income Tax Appellate Tribunal. The Income Tax Appellate Tribunal by its order dated 30th October, 1998 concluded that there was nothing erroneous in the order passed by the Commissioner of Income Tax (Appeals) deleting the disallowance made in respect of **"Reserve for Bad and Doubtful Debts"**.

4. There is no dispute that the Appellant had submitted the Profit and Loss Account to the Controller of Insurance as required under the provisions of the Insurance Act. Mr.Irani, the learned Counsel for the Appellant has pointed out that the Controller of Insurance had accepted the same.

5. Dr.Daniel, the learned Counsel for the Respondent

has sought to contend, relying on the provisions of Section 44 of the Income Tax Act, that under Rule 5(a) it is not permissible to deduct unless it is an expenditure or allowance. Dr.Daniel has contended that unless it is an expenditure or actual allowance, merely by providing the provision for **"Reserve for Bad and Doubtful Debts"** will not be eligible for being deducted while computing the income.

6. Mr.Irani, the learned Counsel for the Appellant has brought to our notice the judgment of the Supreme Court in the case of **General Insurance Corporation of India V/s.Commissioner of Income Tax reported in (1999) 240 ITR 139**, wherein the Supreme Court has observed that Section 44 of the Income Tax Act is a special provision governing computation of taxable income earned from business of insurance, and it mandates the assessing authorities to compute the taxable income for business of insurance in accordance with the provisions of the First Schedule. It is relevant to note that the Controller of Insurance has accepted the above allowance for **Reserve for Bad and Doubtful Debts,** which is binding on Income Tax authorities. Mr.Irani thereafter referred to and relied upon the judgment of the Division Bench of our High Court in the case of **Commissioner of Income Tax V/s General Insurance Corporation of India reported in (2002) 254 ITR 204,** wherein the very issue raised in the present petition has been considered in depth. The Division Bench has observed as under:-

"Mr.Desai, the learned senior Counsel appearing on behalf of Department contended that Section 36(1) refers to deductions required to be allowed in computing the income referred to in section 28 of the Act. He invited our attention to section 36(1)(vii) which refers to writing off of the bad debt or any part thereof as irrecoverable in the accounts of the assessee for the previous year. He pointed out that the words "any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year" were introduced by the Direct Tax Laws (Amendment) Act, 1987 with effect from April 1, 1989. He contended that prior to April 1, 1989, the words were as follows: "any debt or part thereof, which is established to have become a bad debt in the previous year". He also invited our attention to the First Schedule to the Act and, in particular, rule 5. The First Schedule refers to insurance business. It is required to be read with section 44. He contended that, in the present case, we are not concerned with life insurance business. He contended that under rule 5, profits from business of insurance other than life insurance were required to be determined by taking into account balance of the profits disclosed by the annual accounts, subject to the adjustments, viz., any expenditure or allowance including any amount debited to the profit and loss account by way of divident, reserve, or provision for any tax which is not admissible under sections 30 to 43B, shall be added back. He contended that, in the present case, the assessee has transferred the amount to "reserve for doubtful debts". Therefore, the Assessing Officer was right in adding back the aforestated amount of Rs.1.18 crores. He contended that rule 5 was amended by Finance (No.2) Act, 1998, with effect from April 1, 1989. He contended that the judgments relied upon by the assessee have no application as they pertain to the period before April 1, 1989. He contended that none of the judgments have interpreted rule 5 in the First Schedule as amended by the Finance (No.2) Act, 1998. Therefore, the judgments cited by the assessee did not apply to the facts of this case. On the other hand, it was urged on behalf of the assessee, by Mr.Irani, the learned Counsel for the assessee, that section 36(1) provides for deductions to be allowed in computing the income referred to in section 28 of the Act. He pointed out that section 36(2), however, lays down the conditions which an assessee is required to satisfy before claiming deduction for a bad debt or a part thereof. He contended that prior to April 1, 1989, clause (i) in section 36(2) stipulated that no deduction shall be allowed unless any debt or part thereof has been written off as irrecoverable in the accounts of the assessee. He pointed out that after April 1, 1989, however, the Legislature has removed the above condition from section 36(2) and has transferred it under section 36(1)(vii). Therefore, he contended that there is no basic change brought about by the Legislature and the law, as it stood before April 1, 1989, remains the same. He, therefore, contended that the Tribunal has rightly relied upon the judgments of the Bombay High Court in

the case of CIT v.Jwala Prasad Tiwari (1953) 24 ITR 537. He also relied upon the judgment of the Gujarat High Court in the case of Sarangpur Cotton Mfg. Co.Ltd v.CIT (1983) 143 ITR 166. Both these judgments have laid down that if an amount is transferred to a bad debt reserve account in the books of an assessee, it would amount to writing off the bad debt and it was not necessary that the amount should be altogether taken off from the boks of the assessee. Mr.Irani further invited our attention to rule 5(a) of the First Schedule to the Act. He pointed out that the said rule has no application. He contended that rule 5(a) applied to cases where an expenditure or allowance including any amount debited to the profit and loss account either by way of reserve is not admissible under the provisions of sections 30 to 43B, then, in computing the profits, the said amount shall be added back. In this case, however, he contended that the burden was on the Department to prove that the amount debited by the assessee to the profit and loss account was not admissible under section 36(1)(vii). Hence, rule 5(a) was not applicable to the facts of this case."

7. The Division Bench has further obverved as under:-

"At the outset, we may mention that the question as to whether the debt has become irrecoverable has not been raised in the appeal. It is a factual dispute which ought to have been raised. The only dispute which has been raised is, whether rule 5(a) of the First Schedule to the Act is attracted by the mode in which the amount of Rs.1.18 crores has been transferred to "reserve account for doubtful debts". In the case of Jwala Prasad Tiwari (1953) 24 ITR 537, the Bombay High Court had held that the expression "writing off" is a technical term used by the auditors. That, there are two methods of dealing with a debt which has been writtem off in the books of account, viz. by giving corresponding credit to the debtor’s account or by giving corresponding credit to the bad and doubtful debts account. The first method is only employed where it is desired to close the account of the debtor. The second method is employed where there are some chances of recovery. That, when we talk of "writing off", we are not concerned with the credit to be given to an account. That, "writing off" means raising a debit entry. This can only be to the debit of the profit and loss account. That, this is the only debit which can be raised as a result of writing off as bad debt. To the same effect is the judgment of the Gujarat High Court in the case of Sarangpur Cotton Mfg. Co.Ltd. (1983) 143 ITR 166. In the case of Vithaldas H.Dhanjabhai Bardanwala v.CIT (1981) 130 ITR 95, the Division Bench of the Gujarat High Court has held that under section 36 of the Act, before any claim for allowance for a bad debt is held established by the Assessing Officer, it must appear that the concerned bad debt was written off as irrecoverable in the account books of the assessee. This requirement is a condition for the grant of claim

for bad debt allowance. To that extent, there is a departure from the earlier Act. However, so far as the exact requirement of the writing off is concerned, the language used in the Indian Income-tax Act, 1922 and the 1961 Act is identical. If the debit entries posted by the assessee indicate that bad debt has been written off as irrecoverable in the accounts of the assessee, then the statutory condition stands fully complied with. That, if the assessee has posted entries in the profit and loss account and the corresponding entries are posted in the bad debt reserve account, it would be sufficient compliance with the provisions of the statutory requirement for writing off as irrecoverable the concerned debt in the books of the assessee. These judgments squarely apply to the facts of our case. In the present matter, the assessee has posted entries in the profit and loss account and has made corresponding entries in the bad debt reserve account. Therefore, there is compliance with section 36(1)(vii). It may be noted that prior to April 1, 1989, this statutory requirement existed under section 36(2)(i). That entry has been shifted and brought to section 36(1)(vii). Therefore, to the extent of the exact requirement of writing off of the concerned debt as irrecoverable, the law remains the same even after April 1, 1989. Hence, there is compliance with section 36(1)(vii). Rule 5(a) of the First Schedule, inter alia, lays down that where any expenditure or allowance is debited to the profit and loss account by way of reserve which is not admissible under the provisions of section 36(1), then the amount shall be added back in computing the profits of the business. However, in the present case, as stated hereinabove, there is full compliance with section 36(1)(vii). The manner of writing off is as per the statutory requirement. The Department has not raised the relevant factual dispute as to whether the debt has not become irrecoverable. In the circumstances, question No.2 is answered in the negative, i.e. in favour of the assessee and against the Department".

8. In the present matter, we had even directed the learned Counsel for the Appellant to give exact details as to the extent of the debt for which the aforesaid **"Reserve for Bad and Doubtful Debts"** was made. In accordance thereto, an affidavit dated 15th July, 2005 has been filed by the Appellant, wherein we find that the provision has been made after a detailed scrutiny and the said provision has been duly approved by the Board as indicated in the said affidavit. The

particulars of **Reserve for Bad and Doubtful Debts** as on 31.3.1991 pertaining to Assessment Year 1991-1992 have been given at Exhibit ‘D’ to the said Affidavit.

9. The above issue whether the **"Reserve for Bad and Doubtful Debts"** can be allowed to be deducted while computing the income, has already been concluded by the Division Bench judgment of our High Court in the aforesaid case of **Commissioner of Income Tax V/s.General Insurance Corporation of India.** Hence, we answer the substantial question of law raised in the present petition in the affirmative, in the sense, in favour of the Appellant-Assessee and against the Respondent-Revenue.

(DR.S.RADHAKRISHNAN J.)

(J.H.BHATIA J.)